



STATE BOARD OF EQUALIZATION

LEGAL DIVISION - MIC 82
450 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082)
Office No. (916) 322-0050
Fax No. (916) 323-3387

JOHAN KLEHS
First District, Hayw

DEAN AND.
Second District, Stockton

ERNEST J. DRONENBURG, JR.
Third District, San Diego

BRAD SHERMAN
Fourth District, Los Angeles

KATHLEEN CONNELL
Controller, Sacramento

June 16, 1995

BURTON W. OLIVER
Executive Director

1

Dear Ms. :

This is in response to your letter of May 24, 1995 in which you request our opinion regarding the property tax consequences resulting from the following facts described in your letter.

In 1982 Husband (H) and Wife (W) transferred all of their property into a trust. H and W were both trustees and trustors of the trust. On August 8, 1986, W died.

The trust instrument required that after W's death, part of the trust property be placed in a bypass trust (BP Trust) for the use of H while he lived and the balance of the trust property be placed in a surviving spouse's trust (SS Trust) for H to do with as he desired.

The trust instrument provided in relevant part:

1. The SS Trust was revocable by H.
2. The BP Trust was irrevocable.
3. The entire net income of the BP Trust was required to be paid to or applied for the benefit of H in monthly or other convenient installments during H's entire lifetime.
4. In the event that the trustee determined that the income which any child of H and W was receiving from all sources was insufficient to provide for such child's health, support and maintenance in accordance with the standard of living which such child enjoyed as of the date of the declaration of trust, the trustee "may pay to such child or apply for such child's benefit so much of the principal of the [BP

Trust} as shall be necessary or proper for such purposes...."

After the death of W, all of the income from the BP Trust was paid to H and no part of the principal of the BP Trust was invaded for the benefit of the children of H and W. After H's death on April 8, 1991, the real property held in the BP Trust was distributed to the children of H and W in accordance with the trust instrument.

From your letter it appears that the Tulare County Assessor's Office (Assessor) reappraised the real property in the BP Trust as of the date of W's death as a result of what the Assessor considered to be a change in ownership as of that time. Apparently, the Assessor's position is that the interspousal exclusion (Rev. & Tax. Code¹ §63, Rule 462.160 (b)(4) and Rule 462.220 (a) & (b)) was not applicable with respect to the real property contained in the BP Trust.

Your letter indicates that in reaching his decision, the Assessor relied, at least in part, on Board legal staff correspondence dated August 31, 1981 which is annotated at page 5411 of the Property Taxes Law Guide.

The third point of that annotation states that "[i]f the trustee has the discretion to distribute income among the surviving spouse and others, the surviving spouse is not the sole present beneficiary of the trust, and the property cannot qualify for the interspousal exclusion." The foregoing is apparently the part of the annotation cited by the Assessor in support of his position that the interspousal exclusion is inapplicable in this case.

The annotated letter still reflects the Board legal staff's interpretation of section 63 and Rules 462.160 (b)(4) and 462.220 (a) & (b) regarding the applicability of the interspousal exclusion to trusts. In our view, however, the trust provisions in the quoted annotation are distinguishable from the trust provisions in this case, and that part of the annotation, therefore, is inapplicable.

We believe, however, that the first point in the annotation does apply in this case. It states in relevant part:

¹ All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

For the property which passes to the "B" trust to qualify for the interspousal exclusion, the surviving spouse must be the sole present beneficiary of the trust....(Emphasis added.)

In this case, there was no discretion in the trustee to distribute income among the surviving spouse and others as there was in part three of the annotated letter. Instead, the trustee was required by the trust instrument to distribute all of the BP Trust income to or for the benefit of H during his lifetime and, in fact, did so. H was essentially given a present life estate in the trust property. Such an interest is clearly a present and not a future interest. Civil Code section 767. Nobody else but H was entitled to receive nor did receive any income from the BP Trust. Further, no other beneficiary but H had a present interest in the trust property. The children had the right to the property upon H's death, i.e., an equitable remainder interest, which is clearly a future interest rather than a present interest. Civil Code section 769. Moreover, as explained below, the possibility that the children could receive property through the trustee's invasion of the trust principal is also a future interest.

In contrast, the surviving spouse in part three of the annotated letter was not entitled to receive any of the trust income because the trustee was not required to distribute income to anybody. The trustee had discretion to distribute income to any, all or none of a group which included the surviving spouse and others. Thus, the surviving spouse in that example could not be characterized as the sole present beneficiary of the trust.

With respect to the trustee's discretionary power to distribute principal to either or both the children of H and W, it is our view that under such provisions the children do not share a present interest with the income beneficiary because such an interest is a mere expectancy. *Estate of Canfield* (1947) 80 Cal.App.2d 443, 451; *Estate of Johnson* (1961) 198 Cal.App.2d 503, 510. Similarly, the interest created by such a provision has been characterized as a future interest as opposed to a present interest for federal gift tax purposes because the exercise of the discretion of the trustee is a barrier to the children's present enjoyment of the trust principal. *Jacobson v. U.S.* (1973) 42 AFTR 2d 78-6499. See attached letter to Honorable Emil G. Shubat dated June 19, 1987 which addresses the same issue in a similar context.

Accordingly, it is our position and it has consistently been our position since the adoption of Proposition 13 that under the circumstances described in this case, the surviving spouse is the sole present beneficiary of the trust. The transfer occurring at the death of the first spouse, therefore, would properly be excluded from change in ownership under the interspousal exclusion.

I have spoken to Mr. Roland Hill of the Assessor's Office regarding this matter and he suggested that I send a copy of this letter to the Assessment Appeals Board where this matter is now pending. Mr. Hill also volunteered to request that the Assessment Appeals board not issue a decision in this matter before receiving a copy of our letter. The views expressed in this letter are, of course, not binding upon the Assessor or the Assessment Appeals Board.

Our intention is to provide courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this objective are appreciated.

Sincerely,



Eric F. Eisenlauer
Senior Staff Counsel

EFE:ba
Enc.

cc: Mr. John Hagerty - MIC:63
Mr. Dick Johnson - MIC:64
Ms. Jennifer Willis - MIC:70

Mr. Roland Hill - Tulare County Assessor's Office
Tulare County Assessment Appeals Board